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## **OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT**

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# **Review of Fiscal Year 2009 Year-End Budget Monitoring Report**

## **OVERVIEW**

The Chief Financial Officer issued the Fiscal Year 2009 Year-End Budget Monitoring Report on May 1, 2009. It describes the current status of revenues and expenditures, and year-end projections, based on actual (unaudited) data from July 1, 2008 through March 6, 2009 (Period 9 out of 13).

The IBA reviewed the Year-End Report, comparing the information to the Mid-Year Monitoring Report (presented to the Budget and Finance Committee on March 11, 2009), the Comptroller's most recent Financial Performance Report for Period 8 (distributed to the Council on March 13, 2009), and the CFO's FY 2009 Sales Tax Revenue Update, dated March 26, 2009.

In summary, this report highlights significant changes to projections and assumptions since the Mid-Year Report, offers suggestions on areas needing further review and discussion, and highlights issues which may impact assumptions contained in the FY 2010 Proposed Budget.

Next steps include a request for City Council action to amend the Fiscal Year 2009 Appropriations Ordinance to authorize the City Comptroller to complete the financial transactions detailed in the Year-End Report, in order to balance City departments and funds at fiscal year-end. This is expected to be scheduled for the City Council meetings of May 26 and June 1, 2009.

## FISCAL/POLICY DISCUSSION

### General Fund Status

The following chart summarizes the changes in budgeted revenues and expenditures, and compares revised projections, since the beginning of the fiscal year. Based on the Year-End Projection, General Fund revenues are now projected to be \$53.7 million less than the Adopted Budget, which is a 4.5 percent decrease. General Fund expenditures are projected to be slightly less than revenues, and \$55.1 million less (or 4.6 percent lower) than the Adopted Budget. The Year-End Projection reflects an \$8.4 million decrease in revenues and a \$8.1 million drop in expenditures, from the projections made in the Mid-Year Report.

| General Fund Status<br>Fiscal Year 2009 |                              |  |                              |   |   |
|---|------------------------------|--|------------------------------|---|---|
|   | FY 2009<br>Adopted<br>Budget | FY 2009 Year-<br>End Projection<br>(First Quarter) | FY 2009<br>Revised<br>Budget | FY 2009 Year-<br>End Projection<br>(Mid-Year) | FY 2009 Year-<br>End Projection<br>(Year-End) |
| Revenues                                | \$1,192,608,391              | \$1,144,518,906                                    | \$1,156,037,357              | \$1,147,299,716                               | \$1,138,944,776                               |
| Expenditures                            | 1,192,608,391                | 1,175,589,409                                      | 1,156,037,357                | 1,145,567,794                                 | 1,137,514,412                                 |
| Net Balance                             | --                           | (\$31,070,503)                                     | --                           | \$1,731,922                                   | \$1,430,364                                   |

The FY 2009 Revised Budget reflects budget reductions and other actions enacted to date to address revenue shortfalls due to the economic decline, for a net reduction of \$36.6 million from the Adopted Budget. The Mid-Year Projection reflected further shortfalls in revenues of \$8.7 million, and additional expenditure savings of \$10.4 million from the Revised Budget. As the Mid-Year Projection reflected a positive net balance of \$1.7 million at year-end, no additional budget adjustments were recommended at that time. However, in order to achieve the projections now shown for Year-End, additional budget adjustments are recommended, and would result in a net balance of \$1.4 million.

### General Fund Revenue

#### *Major Revenues*

The FY 2009 Year-End Report reflects continued declines in a number of the major General Fund revenue projections. Sales tax revenue is projected to end the fiscal year \$3 million lower than what was projected in the Mid-Year Report, while TOT and property transfer tax are expected to decline by an additional \$1.4 million and \$640,000, respectively. While these declines are offset by expenditure savings in FY 2009, we are concerned that the lower year-end revenue projections may impact the FY 2010 budget by establishing a lower revenue base from which growth projections are made. In addition, the continued decline in the FY 2009 revenue projections may indicate that lower growth rates are warranted for FY 2010. These potential impacts are particularly relevant for TOT and property transfer tax, which were budgeted in FY 2010 based on the FY 2009 Mid-Year projections. There is less of a concern with sales tax, as the FY 2010 budget was based on the revised FY 2009 projection, as detailed in a March 26,

2009 memorandum from the CFO. However, we recommend that additional information be provided on the potential FY 2010 impact for both TOT and property transfer tax, and expect this to be addressed in the Mayor's May Revise.

#### *Other Major Revenue*

The Year-End Report includes the transfer of \$1.0 million from the Library Operating and Maintenance Fund for FY 2009, which was not originally planned. In our Review of the FY 2010 Proposed Budget, the IBA recommended that this fund be reevaluated and that recommendations for its use be presented by the Library Department to the Budget and Finance Committee by September 2009 (Recommendation # 27). Transferring the balance now as part of the actions to mitigate revenue shortfalls in FY 2009 would eliminate this funding source, without further discussion with the Council regarding alternative uses or the impacts to the Library Department. In addition, as the General Fund is projected to end the year with a surplus of \$1.4 million, this transfer does not appear necessary at this time. The Budget and Finance Committee may wish to discuss how the Library Operating and Maintenance Fund should be addressed, and consider postponing the use of the fund balance until it is further evaluated, as previously recommended.

#### **Departmental Revenues**

Year-End projections for departmental revenues total \$288.3 million, down by \$4.8 million from the Mid-Year Report. The table at the right reflects the significant changes in departmental revenue estimates since the Mid-Year Report, which comprise \$3.06 million of the net reduction in this category. Greatest changes since the Mid-

| Departmental Revenues<br>Significant Changes from Mid-Year Report<br>FY 2009 |   |   |
|--|---|---|
| Department   | FY 2009 Year-<br>End Projection<br>(Mid-Year) | FY 2009 Year-<br>End Projection<br>(Year-End) |
| City Attorney  | \$5,941,312                                   | \$4,115,317                                   |
| City Treasurer   | 27,429,980                                    | 27,036,276                                    |
| Fire-Rescue  | 12,927,630                                    | 15,083,117                                    |
| Police   | 46,305,401                                    | 43,602,150                                    |
| Engineering and Capital Projects   | 59,193,928                                    | 58,150,705                                    |
| General Services   | 40,478,624                                    | 41,225,565                                    |
| Subtotal Listed Departments  | \$192,276,875                                 | \$189,213,130                                 |
| Departmental Revenues  | \$293,093,355                                 | \$288,253,398                                 |

Year Report are a \$2.7 million reduction in the Police Department, a \$1.8 million reduction related to the City Attorney, and a \$1.0 million reduction in Engineering, which is offset somewhat by an increase of \$2.16 million in the Fire-Rescue Department.

#### **General Fund Expenditures**

The following chart summarizes General Fund expenditures by category throughout the fiscal year. The summary shows some categories proved to be somewhat volatile throughout the year, like projections for fringe benefits, information technology, and energy and utilities, whereas salaries and wages, and equipment outlay reflect a gradual decline in expected expenditure levels consistent with restricted hiring and spending.

| General Fund Expenditure Status by Category<br>Fiscal Year 2009 |   |  |  |   |   |
|---|---|--|--|---|---|
|   | FY 2009<br>Adopted<br>Budget<br>July 2008 | FY 2009 Year-<br>End Projection<br>(First Quarter)<br>Oct 2008 | FY 2009<br>Revised<br>Budget<br>Dec 2008 | FY 2009 Year-<br>End Projection<br>(Mid-Year)<br>March 2009 | FY 2009 Year-<br>End Projection<br>(Year-End)<br>May 2009 |
| Salaries and Wages  | \$541,702,137                             | \$535,045,069  | \$530,892,235                            | \$521,051,618   | \$520,166,666   |
| Fringe Benefits   | 283,970,410                               | 288,164,386  | 284,034,674                              | 284,213,636   | 280,186,588   |
| Supplies/Services   | 292,779,717                               | 279,297,437  | 268,054,684                              | 268,268,651   | 267,531,427   |
| Info Technology   | 36,781,869                                | 37,185,666   | 36,679,176                               | 36,815,090  | 37,297,517  |
| Energy/Utilities  | 27,774,538                                | 28,710,735   | 27,758,408                               | 28,790,115  | 28,057,563  |
| Equipment Outlay  | 9,599,720                                 | 7,186,115  | 8,618,181                                | 6,428,684   | 4,274,651   |
| Total   | \$1,192,608,391                           | \$1,175,589,409  | \$1,156,037,357                          | \$1,145,567,794   | \$1,137,514,412   |

The Year-End Report now shows savings in Salaries and Wages of \$21.5 million compared to the Adopted Budget (or almost 4 percent), which includes an increase of just \$884,952 compared to the Mid-Year Report. (Savings compared to the Revised Budget total \$10.7 million in this category, mostly due to vacancies throughout City departments.)

Savings in all other categories, including fringe benefits and non-personnel expenses, total \$33.6 million compared to the Adopted Budget (or 6.4 percent), which has increased by \$7.2 million since the Mid-Year Report. (Savings compared to the Revised Budget total \$7.8 million in these categories.)

## **SALARIES AND WAGES**

The Year-End Report reflects only a slight change to the projections for Salaries and Wages for the General Fund since the Mid-Year Report. Many departments are experiencing large numbers of vacancies which contribute to salary savings and assist in ensuring the General Fund is balanced at the end of the year.

### *Police*

Most significantly, the Police Department is estimating salary savings of \$6.9 million due to 177.75 sworn vacancies, which has increased from 172 at the time of the Mid-Year Report. The Council has discussed the potential impacts of increasing numbers of vacancies due to the changes in the labor agreements, and a request has been made for the department's vacancy savings for FY 2010 to be further evaluated, because of this.

## **FRINGE BENEFITS**

At the time of the First Quarter Report, the fringe benefits category was estimated to exceed budgeted levels by \$4 million, and the budget was increased for this purpose. However, after additional review, the Mid-Year Report indicated that several fringe benefit items were collecting funds in excess of needs and Reserve Policy guidelines. Rate adjustments were to be implemented to reduce collections of various fringe accounts, and, in turn reduce the projected expenditures of all City departments. These efforts were expected to create savings to the General Fund totaling \$6.2 million.

Compared to the Mid-Year Report, projections for General Fund Fringe Benefits have now been reduced by \$4 million.

Based on our review, the IBA has verified that collections related to Risk Management Administration and Long-Term Disability ceased in mid-January, however, collections for the Workers Compensation Fund continued. Financial Management staff has indicated that these rates were also stopped in early April. The IBA will continue to assess the funding level of the Workers Compensation Fund and its reserve as part of our continuing budget review, and may have recommendations at a later date.

## **SUPPLIES AND SERVICES**

### *City Auditor*

Funds were not included in the FY 2009 Budget to cover the outside audit of the City's FY 2009 financial statements. In order for pre-audit fieldwork to begin in the current fiscal year, an appropriation adjustment of \$1 million for the City Auditor's budget has been requested as this department will be administering the outside audit. A RFP process was recently concluded and the Audit Committee has recommended that the City Council approve the selection of Macias, Gini & O'Connell to perform outside auditing work for the City for Fiscal Years 2009 through 2013. The contract is anticipated to be docketed for City Council consideration in early June 2009. Funding has been appropriately budgeted in the City Auditor's FY 2010 budget for the outside audit of the City's FY 2010 financial statements.

### *Storm Water*

An ongoing concern is the Storm Water Department's ability to expend all budgeted funds by the end of the fiscal year. Through Period 9, the Department has expended just \$14.5 million out of a revised budget of \$43 million. According to the Year-End Report, the Department projects to end the fiscal year with expenditures only \$1.8 million under budget. However, this projection includes funds that are anticipated to be encumbered but not expended in the current fiscal year. Additional information should be provided on how much of the Department's FY 2009 Revised Budget will be encumbered by year-end, including detail on the specific contracts and projects for which funding will be encumbered, additional Council actions that may be required, and the timeframe in which encumbered funds will actually be expended.

### *Citywide Program Expenditures – General Fund Reserve Contribution*

The First Quarter Report eliminated the \$3.7 million contribution to the General Fund Reserve, needed at the time of budget development to ensure the Reserve Policy goal of 6.5 percent would be met. In November, the Reserve balance was reported as higher than previously estimated, eliminating the need for the budgeted contribution. The Mid-Year Report described that the Reserve balance had been reduced due to activities by the Comptroller to close the books on the prior year, triggering the need to reinstate a \$3.0 million contribution. Now, the Year-End Report further revises this projection, reducing the need to \$2.5 million.

The FY 2010 Proposed Budget reflects the current balance of the reserve at \$71.5 million as the ending balance for FY 2009, without the projected contribution of \$2.5 million. In addition, the contribution for FY 2010 is described as coming from released

encumbrances totaling \$8.7 million, and no further need for funding from the General Fund in order to meet the policy goal target of 7 percent.

| Citywide Program Expenditures<br>Significant Changes from Mid-Year Report<br>FY 2009 |   |   |
|--|---|---|
| Program  | FY 2009 Year-End Projection<br>(Mid-Year) | FY 2009 Year-End Projection<br>(Year-End) |
| General Fund Reserve Contribution  | \$3,055,175                               | \$2,512,103                               |
| Property Tax Administration  | 4,027,643                                 | 4,482,661                                 |
| Wildfire Fee Waivers   | 2,200,000                                 | 2,280,000                                 |
| Special Consulting Services  | 836,159                                   | 355,000                                   |
| Subtotal   | \$9,918,977                               | \$9,629,764                               |
| Citywide Program Totals  | \$60,471,250                              | \$60,148,624                              |

In our Review of the FY 2010 Proposed Budget, the IBA discussed that the FY 2009 contribution and the FY 2010 release of encumbrances to augment the General Fund Reserve was unclear. It is now our understanding that the reserve policy goal is intended to be achieved through a combination of the \$2.5 million General Fund contribution in FY 2009 (as shown in the Year-End Report), with the remaining amount needed for FY 2010 (\$6.2 million) to come from encumbrances releases, in order to reach the reserve target of \$80.2 million and 7 percent.

#### *Citywide Program Expenditures - Property Tax Administration Fee*

The Mid-Year Report included an increase of \$1.0 million related to the Property Tax Administration Fee paid to the County. The Year-End Report reflects a further increase of \$455,000 for this purpose. The FY 2010 Proposed Budget includes an increase of \$1.1 million, consistent with the Mid-Year Report. The IBA suggests that the Financial Management Department evaluate this requirement to determine if sufficient funding has been budgeted in the FY 2010 Proposed Budget given the increased level of spending shown in the FY 2009 Year-End Report.

### **EQUIPMENT OUTLAY**

The IBA notes that the General Fund is projecting significant savings in the category of Equipment Outlay, comprising over 50% of the FY 2009 Adopted Budget. The IBA called for a rigorous review of this category at the First Quarter Budget Adjustments, estimating that more savings could be found here than requested at that time. Indeed, since then, the departments have looked to their Equipment Outlay budgets to realize further savings for FY 2009 that are a crucial component of the overall balance of the fund. As mentioned in our Review of the Mayor's FY 2010 Proposed Budget (IBA Report 09-37), Equipment Outlay bears serious scrutiny in the budget process and throughout the year, as it is consistently an area that is underexpended or that provides savings in times of reductions. The IBA continues to recommend a zero-based budgeting process for Equipment Outlay to ensure funds are budgeted appropriately and precisely.

### Requests for Appropriation Adjustments

Appropriation adjustments total a net reduction of \$2.6 million to both revenues and expenditures, and reflect the reallocation of funding among departments that are projected to overexpend for particular reasons, some of which are described earlier in this report. In addition, the Fire-Rescue Department has also received additional revenues which will be appropriated to offset increased costs, totaling \$4.25 million. Appropriation Adjustments are outlined in Table 13 in the Year-End Report.

### Status of Non-General Funds

#### *Development Services Department*

Due to the current economic climate, the Development Services Department is projecting a net \$4.3 million deficit at the end of the fiscal year. The net \$4.3 million deficit is a result of revenues projecting to be \$6.9 million under budget, mitigated by expenditure savings of \$2.6 million. Projected revenues reflect the reimbursement of \$1.7 million from the General Fund related to the waiver of permit fees as a result of the 2007 wildfires. Department management has stated that the \$4.3 million deficit will be offset by a reduction to enterprise fund reserves. However, the level of reserves and the fiscal health of this fund continue to be a concern for the IBA.

#### *Fleet Services*

The FY 2009 Year-End Report reflects expenditure savings of approximately \$6.8 million in the Fleet Services Internal Service Fund, partially attributable to savings in fuel costs. As recommended in the IBA Review of the Fiscal Year 2010 Proposed Budget, consideration should be given to using this surplus funding to establish a fuel reserve to guard against unanticipated price increases in future years.

#### *Public Utilities*

Both the Water and Sewer Department are projected to end the fiscal year with expenditures significantly under budget. The Water Department is projecting to spend \$521.4 million out of a revised budget of \$709.1 million, while the Sewer Department projects expenditures to be \$328.5 million compared to a revised budget of \$619 million. These variances are largely attributable to the way in which capital improvements projects are budgeted. The annual CIP budget for both Water and Sewer reflect appropriations, not planned expenditures. Because most capital projects are multi-year in nature, actual CIP expenditures within a fiscal year are typically made from prior year appropriations. As a result, there is limited nexus between the CIP budget and capital expenditures within a given fiscal year.

Despite this budgetary practice, there is still concern regarding the rate at which capital projects are being executed. However, based on the FY 2009 Year-End Report, it is not possible to discern between capital and operating expenditures. In the future, we recommend that year-end projections for operating expenditures in the Water and Sewer

Department be separated from CIP expenditures in order to more accurately reflect budget variances.

## CONCLUSION

The IBA reviewed the Year-End Report, comparing information to the Comptroller's most recent Monthly Financial Report, and also the First Quarter and Mid-Year Monitoring Reports. This report provides comparisons with projections that have been made throughout the year, focusing primarily on the General Fund, and highlights significant actions to be requested of the Council. Some areas may need additional review and could impact projections and assumptions contained in the FY 2010 Proposed Budget, which could be addressed in the Mayor's May Revise.

The Year-End Report includes the transfer of \$1.0 million from the Library Operating and Maintenance Fund for FY 2009, which was not originally planned. The IBA has recommended that this fund, along with other such funds, be reevaluated and recommendations be presented to the Budget and Finance Committee by September 2009. Transferring the balance now as part of the actions to mitigate revenue shortfalls in FY 2009 would eliminate this funding source, without further discussion of alternative uses or impacts to the Library Department. Since the General Fund is projected to end the year with a surplus of \$1.4 million, the Budget and Finance Committee may wish to discuss how the Library Operating and Maintenance Fund should be addressed, and consider postponing the use of the fund balance until it is further evaluated.

The IBA will continue to assess the funding level of the Workers Compensation Fund and its reserve as part of our continuing budget review, and may offer recommendations at a later date. In addition, the IBA suggests additional information should be provided on how much of the Storm Water Department's FY 2009 Revised Budget will be encumbered by year-end, including detail on the specific contracts and projects for which funding will be encumbered, additional Council actions that may be required, and the timeframe in which encumbered funds will actually be expended.

The IBA recommends that the Budget and Finance Committee recommend that the City Council authorize the requested appropriation adjustments and related actions, in order to ensure a balanced budget at fiscal year-end.

**[SIGNED]**

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**[SIGNED]**

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